Compensation
Advisory Partners

Alert // December 14, 2021

ISS Updates Frequently Asked Questions for COVID-Related Pay Decisions

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ISS recently issued Frequently Asked Questions (FAQs) related to COVID-19 pay decisions. The updated FAQs explain how ISS will approach COVID-related compensation issues for the 2022 proxy season. This article focuses on changes since last year's guidance and we also note where the FAQs did not change. CAP's 2020 summary can be found here.

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Similar to the guidance provided last year, ISS' qualitative evaluation will take into consideration the impact on company operations as a result of the pandemic and an elevated concern from the quantitative screen will continue to result in a more in-depth qualitative review of the company's pay programs and practices. ISS also highlighted the fact that investors believe that in 2021 boards were in a position to return to traditional pre-pandemic incentive structures and want a strong link to performance.

COVID-Related Changes to Annual Incentive Programs

Given that 2022 will be the third proxy season since the advent of the COVID-19 pandemic, ISS states that the "surprise element of the pandemic in early 2020 is generally no longer applicable." As such, the presence of mid-year changes to metrics, performance targets, and/or performance measures, or programs that rely heavily on discretion, will be viewed negatively by ISS, especially if the company displays a quantitative pay for performance misalignment. ISS will allow for lower pre-set targets relative to the prior year as well as moderate increases to the weighting of subjective criteria if the company in question has "continued to incur severe economic impacts and uncertainties as a result of the pandemic in 2021."

ISS emphasizes that a lower performance target should be accompanied by disclosure explaining the board's rationale and how the board determined payout possibilities, particularly if the payout opportunities are not commensurately reduced.

COVID-Related Changes to Long-Term Incentive Programs

ISS' guidance has not changed since last year. Adjustments to in-progress long-term incentive programs will be viewed negatively, particularly if the company has been flagged for having a quantitative pay for performance misalignment. If companies continue to incur negative impacts over a long-term period, modest alterations to going-forward awards may be considered reasonable by ISS. More drastic changes, such as making long-term equity predominantly time-based or instituting shorter performance periods, will continue to be viewed negatively. Any changes to the program should be explained clearly by the company.

Changes to Pay Program Beyond the Year in Review

If a company has made significant adjustments to its pay program that ISS would typically view as concerning, a clear statement that the company intends to return to a robust performance-based program going forward may be viewed as a mitigating factor by ISS. The extent to which ISS may support the changes depends on the detail of disclosure and extent to which the changes are meaningfully positive.

COVID-Related Retention or One-Time Awards

ISS' guidance has not changed since last year. In the event of a one-time award, a rationale for the award should be clearly disclosed, as well as a description on how the award is in shareholders' interests. Companies should avoid boilerplate language regarding "retention concerns." Any such award should be reasonable in magnitude and an isolated practice. Vesting conditions to any such award should be significantly performance-based and long-term. The award should have guardrails, such as limitations on termination-related vesting, to avoid windfall scenarios.

Well-structured retention or other one-time awards may be appropriate in limited circumstances, but investors do not expect companies to grant such awards as a replacement for forfeited performance-based awards. To the extent that this is the case, companies should explain the specific issues driving the decision to grant the awards and how the awards further investors' interests, as well as how such awards do not merely insulate executives from lower pay.

Responsiveness Policy

ISS also released information about its responsiveness policy considering COVID-19. When a company receives less than 70 percent support on a say-on-pay proposal, ISS' responsiveness policy reviews three factors:

- The disclosure of the board's shareholder engagement efforts (no change);
- The disclosure of the specific feedback received from dissenting investors (no change); and
- Any actions or changes made to pay programs and practices to address investors' concerns.

The guidance notes that the expectations regarding the first two factors will remain consistent with prior years. ISS' policy with respect to the third factor will return to its pre-pandemic application. The company must demonstrate that it has responded to negative shareholder feedback, including feedback in response to one-time COVID pay decisions, in which case the board could demonstrate responsiveness by committing not to repeat the action viewed as problematic by the investors. The previous ISS guidance for the third bullet noted above had stated, "With respect to the third factor, if a company is unable to implement changes due to the pandemic, the proxy statement should disclose specifically how the pandemic has impeded the company's ability to address shareholders' concerns. If pay program changes are delayed, or do not necessarily fully address shareholder feedback, the company should disclose a longer-term plan on how it intends to address investors' concerns."

This article highlights updates to ISS' COVID-related compensation FAQs. The ISS document can be found here.